
The Physician's Guide to Asset Protection Planning

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Table of Contents

Introduction	1
Chapter 1 The Family Limited Partnership	4
Chapter 2 The Limited Liability Company	7
Chapter 3 Ownership of FLP or LLC Interests	11
Chapter 4 The Personal Residence Trust	13
Chapter 5 The Family Savings Trust	15
Chapter 6 The Offshore Limited Liability Company	17
Chapter 7 Equity Reduction Plan	19
Summary of Asset Protection Strategies	23
Choosing the Right Plan	25
Questions and Answers	29

Introduction

The most important component of every successful financial plan is a program designed to address particular dangers which pose a threat to your financial security.

How should you organize your business and financial affairs to minimize liability and lawsuit risks?

How can you insure that your accumulated wealth and future earnings are insulated and shielded against potential loss?

The Lawsuit Danger

Unlike every other business owner, you, as a physician, are not permitted to legally limit your personal liability for claims against your practice. There is no business structure, allowed in any state, which protects a physician from the primary source of potential liability-lawsuits based on a claim of professional malpractice.

As a result, the threat of litigation, and potential loss, hangs over your head on every case and colors every patient relationship. Any treatment decision, which produces a less than perfect result, will ultimately be scrutinized by a plaintiff's attorney with a large financial stake in proving that what you did was "malpractice." It is never difficult to find an "expert" to back up this claim and testify, for a fee, that you did something wrong.

In court you will face the prospect of unpredictable and seemingly random jury verdicts and awards. Similar facts may produce dramatically different outcomes-nothing in one case and \$10 million in another. It depends on who the jury believes, their sympathy for the plaintiff and how they feel about you and your lawyer.

Verdicts in the tens of millions of dollars occur frequently enough so that the settlement value of all cases increases. The uncertainty caused by the possibility of a massive award forces you (or your insurance company) to settle for "top dollar" if there is any hint of legal liability.

As would be expected, the increase in lawsuit awards and settlements is restricting the availability of liability insurance coverage. According to the American Medical Association, currently 22 states have a "medical malpractice crisis." As insurance companies refuse to write policies in "high-risk" states or for particular specialties, adequate coverage is unavailable or premiums are prohibitively expensive. For many who have insurance now, it is uncertain whether coverage will continue even in the near future.

As insurance companies withdraw coverage, more physicians are forced or choose to practice "bare." In Florida and a growing number of states, there is a professional division between those who have insurance and those who don't. The new tactic in malpractice cases is for the plaintiff's attorney to target the uninsured physician. In exchange for damaging testimony against another doctor on the case, the uninsured physician is dismissed-allowing him to avoid huge legal fees and a potentially disastrous judgment.

The Physician's Guide to Asset Protection Planning

Verdicts In Physician Malpractice Cases:

\$140 million was awarded to Samuel Desiderio who suffered brain damage following surgery at a New York City hospital. A state court jury awarded him a hefty \$80 million for medical expenses and pain and suffering. In April, an appeals court approved boosting the award against his doctors and the hospital.

Obstetrics produced some of the largest malpractice awards ever;

\$94.5 million to a woman who prematurely delivered a baby with cerebral palsy. She claimed that the physicians failed to give her corticosteroids so the baby's lungs would mature faster. A Brooklyn, N.Y. jury decided the case, Perez v. St. John's Episcopal Hospital, in March (2002)

\$91 million to a 5-year-old girl with cerebral palsy whose lawyers said physicians delivered by cesarean section without realizing her mother was exhibiting symptoms of a rare condition and was not in labor. A Brooklyn jury decided the case, Wise v. McCalla, in December (2002)

\$80 million to a mother who delivered premature twins, one with cerebral palsy. The woman said physicians arrived late and didn't address her uterine cramping complaints. A Long Island, N.Y. jury decided the case, Brenner v. Spector, in October (2002)

(Amednews.com *Malpractice Awards Hit the Jury Jackpot (February 3, 2003)*)

In a single month (November 2003), the following awards are a sample of those reported from around the country:

California – Psychiatrist - \$2,999,999 (Settlement)

District of Columbia – Child Birth - \$50,000,000 (Verdict)

Florida – Failure to Diagnose - \$2,150,000 (Verdict)

Illinois – Childbirth - \$16,225,000 (Verdict)

Michigan – Anesthesiology - \$10,678,000 (Verdict)

New Jersey – Failure to Diagnose - \$3,270,000 (Verdict)

New York – Failure to Treat - \$2,500,000 (Settlement)

New York – Childbirth - \$5,500,000 (Settlement)

New York – Radiologist - \$5,350,000

Ohio – Childbirth - \$3,301,000 (Verdict)

Oklahoma – Childbirth - \$5,000,000 (Verdict)

Texas – Failure to Diagnose - \$8,750,000 (Settlement)

Virginia – Negligent Treatment - \$2,000,000 (Verdict)

South Carolina – Failure to Diagnose - \$1,675,000 (Verdict)

(*VerdictSearch, November 2003*)

Introduction

The Advantages of Asset Protection

Much has now been written about the “litigation explosion” and many professionals and business owners have experienced its impact directly. Asset protection is becoming as common as wills and estate planning. While estate planning usually involves issues associated with preserving and passing property at death, asset protection deals with the immediate need to protect assets during lifetime.

A recent article in the Wall Street Journal cited a survey of individuals with more than \$1 million in assets. In 2003, 35% of those surveyed had some form of asset-protection plan, compared with just 17% in 2000. Of those who did not have an asset-protection plan in place, 61% were now interested in creating one. (The Wall Street Journal, October 14, 2003).

A properly designed Asset Protection Program can accomplish many of your most important objectives:

- **Protection of family savings and investments from lawsuits and claims.**
- **Protection against inadequate or unavailable insurance coverage.**
- **Insulation of rental properties: to reduce your exposure to potential lawsuits.**
- **Protection of business assets and accounts receivable from potential claims.**
- **Elimination of probate.**
- **Reduction of estate taxes.**

Asset Protection Strategies

There are many legal plans which can accomplish sound asset protection. Here we will focus on six important asset protection vehicles which form the foundation of most plans. These techniques will be varied and combined to produce the correct result in any case. But an understanding of these legal strategies will assist you in understanding how your plan should be developed.

1. **The Family Limited Partnership**
2. **The Limited Liability Company**
3. **The Personal Residence Trust**
4. **The Family Savings Trust**
5. **The Offshore Limited Liability Company**
6. **Equity Reduction Plan**

The Family Limited Partnership

The Family Limited Partnership (FLP) is an excellent device for providing a high degree of lawsuit protection for family wealth. When used as part of a properly designed strategy, the Family Limited Partnership can also provide significant income and estate tax savings advantages.

A Family Limited Partnership is a specially designed type of limited partnership. A limited partnership consists of one or more general partners and one or more limited partners. The same person can be both a general and a limited partner, as long as there are at least two legal persons in the partnership. The general partner is responsible for the management of the affairs of the partnership and he has unlimited personal liability for all debts and obligations. Limited partners have no personal liability and stand to lose only the amount contributed to the partnership.

Tax Treatment of Partnerships

Unlike corporations and irrevocable trusts, a partnership is not a taxpaying entity. A partnership files an annual information tax return, but it does not pay tax on its net income. Instead, each partner's share of income is passed through from the partnership to the individual. Each partner claims his share of income on his own tax return.

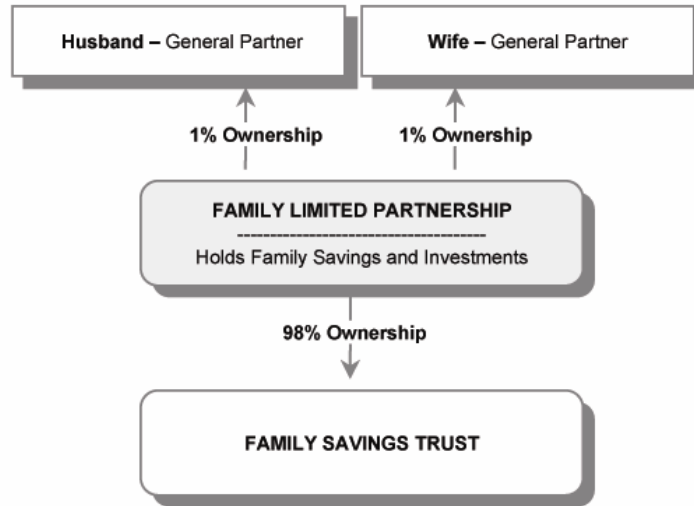
Using Family Limited Partnerships for Lawsuit Protection

Under the typical arrangement, the FLP is set up so that Husband and Wife are each general partners, (A single person can act as the sole general partner). We might use an LLC as the general partner but will keep it simple for illustrative purposes. As such, they might own, for example, a one or two percent interest in the partnership. The remaining interests are in the form of limited partnership interests. These interests are often held in a Family Savings Trust which is described below.

After setting up the FLP, "Safe Assets" usually bank and brokerage accounts are transferred into it. "Dangerous Assets" those which may produce liability such as real estate or business interests, are generally segregated from these "Safe Assets". When the transfers are complete, Husband and Wife no longer own these assets directly. Instead they own a controlling interest in the FLP and it is the FLP which owns the assets. As general partners, they have complete management and control over the affairs of the partnership and can buy or sell any assets they wish. They have the right to retain funds from the sale of any partnership assets or they can distribute these proceeds out to the partners.

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This basic plan is illustrated below.



The Family Limited Partnership

Creditor Cannot Reach Assets

Now, let us see what happens if there is a lawsuit against either Husband or Wife. Assume that Husband is a physician and some time after setting up the FLP there is a lawsuit and a malpractice judgment against him for \$1,000,000. The plaintiff in the action is now a judgment creditor and he will try to collect the \$1,000,000 from Husband.

The judgment creditor would like to seize Husband's bank accounts, investments and other property in order to collect the amount which he is owed. However, he discovers that Husband no longer holds title to any of these assets. Ownership of the FLP is in the Family Savings Trust.

Can the creditor reach into the partnership and seize the property in the FLP?

The answer is no. Under the provisions of the Uniform Limited Partnership Act, the creditor of a partner cannot reach into the partnership and take specific partnership assets. The creditor has no rights to any property which is held by the partnership. Since title to the assets is in the name of the partnership and it is the Husband rather than the partnership which is liable for the debt, partnership assets may not be taken to satisfy the judgment.

Can the creditor seize the limited partnership interests?

We protect the limited partnership interests within a Family Savings Trust or other entity which legally shields the ownership of these interests. If limited partnership interests are held by Husband or Wife, the partnership interests might be subject to a charging order or foreclosure. We discuss in **Chapter 3** the need to protect partnership interests and the techniques available for doing so. For now, we can say that neither FLP interests nor FLP property will be available for the claim of a creditor if the proper arrangement is carefully established.

Estate Tax Benefits

The Family Limited Partnership is also a powerful technique for dramatically reducing or eliminating estate taxes. This estate tax reduction can be accomplished because of certain unique attributes of the FLP which are not present in any other business entity. Of primary importance is the ability to shift the value of assets out of your estate through a program of gifting limited partnership interests to your children or other family members.

IRS rulings and court cases hold that the value of each gift of a limited partnership interest can be discounted in order to account for the lack of marketability and the lack of control associated with those interests. For example, if parents transfer assets with a value of \$5 million to an FLP, a gift of a 1 percent limited partnership interest should not be valued at \$50,000. Instead, because the interest cannot be readily sold and because the child has no right to participate in management of the FLP, a reasonable approach to determine value, suggested by many financial advisors, would be to discount the transferred interest to reflect its true value in the market. Discounts in the range of 30 percent are fairly conservative, but some aggressive advisors push this number to the 50 percent range.

As emphasized in a recent Tax Court case ([Estate of Strangi](#)) and rulings by the IRS, in order to accomplish these dramatic tax savings it is important to respect the legal rights of the limited partners and the legal integrity of the FLP as a separate entity. If you intend to use the FLP to achieve these tax savings the guidelines suggested by these authorities should be carefully followed.

The Limited Liability Company

The LLC is a legal entity created by statute and permitted in all fifty states. The purpose of the LLC is to allow individuals to conduct their financial and business affairs in an efficient and convenient manner. It combines the best features of corporations and partnerships while eliminating many of the problems and complexities associated with each.

The LLC provides the protection from liability of a corporation without the formalities of corporate minutes, bylaws, directors and shareholders. At the same time, the LLC is treated like a partnership for tax purposes. That means that the LLC pays no income tax. All of the income and deductions flow through directly to the members personal tax returns. Further, like a partnership, the owners are permitted to adopt very flexible rules regarding the administration and operation of the business of the LLC.

Advantages of the LLC

To understand the significant benefits offered by the LLC let's look at a typical example.

John and Mary own an apartment building as tenants-in-common. We know that holding the property as they do now, exposes them to great danger. All of their personal assets are exposed to liability from anything that might go wrong concerning the building. Injuries to tenants, problems with lenders, lawsuits from future buyers, all subject everything that John and Mary own to potential liabilities from the property.

To make matters worse, a lawsuit or claim against John or Mary from a situation not related to the building, exposes the apartment property to that claim. Clearly, owning the apartment building in the current manner is not sound business planning. What other options are available to them?

A Corporation Won't Work

John and Mary could transfer the property to a corporation. Each would own 50% of the stock in the company. Since the law provides that the shareholders are not responsible for debts of the corporation, a liability arising out of the property would not subject John and Mary's personal assets to danger.

The problem is that this protection against liability is only available if all of the corporate formalities are carefully followed. Since most people do not maintain proper corporate records and documentation, corporations often do not provide the intended level of protection. Further, corporations are subject to complex tax rules which can cause severe and unintended consequences. Finally, the corporation will not offer protection of the property from outside claims, lawsuits against John or Mary that are unrelated to the property. A creditor can simply seize the stock which they own and reach the apartment building by dissolving the company. For these reasons it is generally not advisable to hold investment real estate in a corporation.

The Physician's Guide to Asset Protection Planning

Limited Partnerships Expose the General Partner to Danger

If John and Mary form a limited partnership to hold the property, one or both of them will serve as general partner. Since the general partner has unlimited liability for the debts of the partnership, if something happens with the building the general partner's assets will be exposed to that claim. The major problem with the limited partnership format is the unlimited liability of the general partner. From a tax standpoint the limited partnership does not cause any adverse tax consequences and, as previously discussed, an outside creditor of John or Mary would not be able to reach the property in the partnership. A creditor suing John or Mary for an outside liability would be limited to a charging order, which would not affect the property in the partnership.

A Limited Liability Company Solves these Problems

By forming an LLC John and Mary can accomplish all of their objectives.

Protection from Inside Liability. The law provides that a member of an LLC is not responsible for the debts of the company. John and Mary would therefore be protected from any claim relating to the apartment building.

No Formalities. An LLC is not required to keep minutes and extensive documentation and the LLC cannot be pierced and the members cannot be sued because of a failure to follow formal procedures. Record keeping requirements can be minimized without a threat that the members will be sued individually for a liability of the LLC.

Protection from Outside Liability. Property held in an LLC cannot be seized by a creditor of a member. As is the case with the Family Limited Partnership, assets of the LLC are protected from potential claims against a member.

Tax Treatment. All income of the LLC is passed through directly to the personal returns of members. This avoids the complications and potential double taxation which plagues the corporate format.

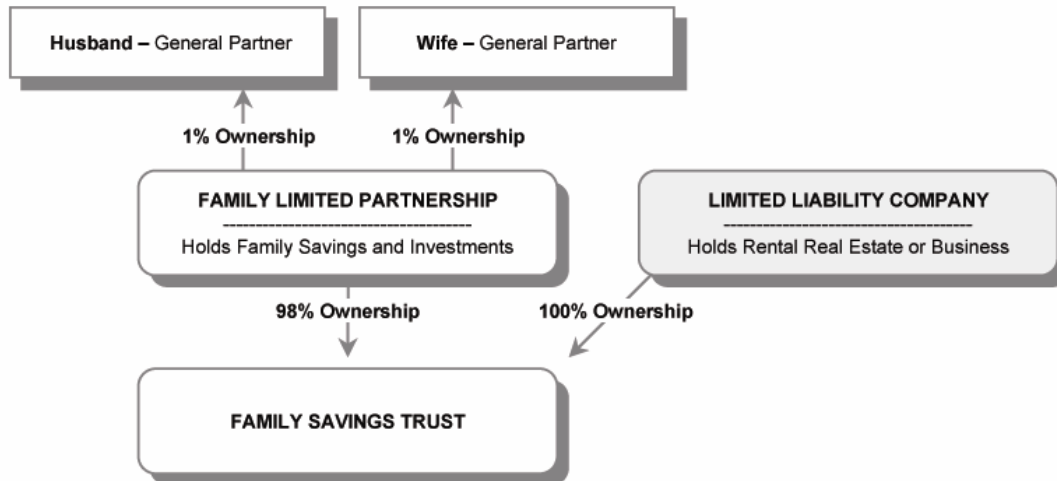
Using the Limited Liability Company for Asset Protection

It should be clear from this discussion that the LLC will generally be the strategy of choice for owning business assets and rental real estate.

In the event of a future lawsuit against the Husband or Wife the assets of the LLC may not be seized by the creditor. As is the case with the FLP, the creditor may obtain a charging order or foreclosure of the LLC membership interests unless they are protected as we will discuss in **Chapter 3**.

The Limited Liability Company

The basic plan involving a Limited Liability Company is illustrated below:



Ownership of FLP or LLC Interests

In every asset protection plan a crucial issue must be addressed. Who should own the interests in the FLP or LLC, if one is established as a part of your plan? Since LLC law is similar in these respects, this discussion will apply to LLCs as well. As we will see, an FLP by itself, without a strategy to protect ownership interests in the FLP will not be useful in most situations. Assume we have created a Family Limited Partnership. Husband and Wife fund it with property worth \$1 million. H and W, or an entity which they control, is the General Partner, holding a 2% interest. Who should own the 98% limited partnership interests? Let's consider the merits of each possible strategy.

Ownership by Husband and Wife

The first alternative is that H and W (or a single individual) hold all or most of the limited partnership interests. The apparent advantage of this arrangement is that it is attractive and convenient. Control is maintained through the General Partnership and equity is preserved through the ownership of the limited partnership interests. This arrangement is generally consistent with the goals of H and W not to part with assets in any meaningful way. The disadvantages of this format are that the interests retained by H and W are subject to a charging order or may be seized by a successful creditor, eliminating any intended asset protection benefits. This remedy is known as a foreclosure and may be particularly powerful in the hands of a knowledgeable plaintiff.

Foreclosure of FLP or LLC Interest

The law generally provides that a judgment creditor of a partner can obtain a charging order against the debtor's partnership interest. The charging order gives the debtor a right to any distributions from the partnership to the debtor partner and remains in effect until the creditor has been paid in full or until the time limit for collecting the judgment has expired (usually 20 years)

In addition to the charging order remedy, many states allow a creditor to foreclose on the debtor partner's interest. (Hellman v. Anderson, 233 Cal. App. 3d 840; California Corporations Code Section 17302 (Foreclosure of LLC interests)). A foreclosure means that the court allows a seizure and sale of the debtor's partnership interest. Although the purchaser of the partnership interest may be restricted in the exercise of any management rights, he would be entitled to the debtor's share of distributions without regard to the amount of the judgment.

For example, a Husband and Wife form an FLP with property worth \$1 million. Some years later there is a judgment against the couple for \$200,000. If the creditor's remedy is limited to a charging order, he would be entitled to distributions equal to the amount of the judgment. When and if he is paid this amount (plus interest) the creditor's judgment is satisfied.

A creditor who is permitted to foreclose on the partnership interest gets more than that. He is legally entitled to distributions without regard to the amount of the judgment. He could ultimately get paid the full \$1 million of value. The timing and fact of any distributions will be subject to legal maneuvering and tactics, but the possibility of a potentially disastrous result must be carefully considered.

The Physician's Guide to Asset Protection Planning

Further, the mere existence of the foreclosure remedy dramatically increases the negotiating leverage of the plaintiff in any situation in which the value of FLP assets exceeds the amount of the judgment. *The threat of a foreclosure by a knowledgeable plaintiff alters the relative bargaining position of the parties by raising the specter of a loss for the defendant beyond even the amount of the judgment.* Pre-litigation and pre-trial negotiations would be impacted by the possibility of a remedy that could cost the defendant more than the amount of a potential judgment. The defendant in this situation would have to liquidate the FLP, if possible (unwinding the asset protection plan) or would be forced to settle on the most unfavorable terms.

In light of these potential problems, we can conclude that ownership of FLP interests (or LLC interests) in an unprotected form by an individual, Husband and Wife, or a living trust, creates significant danger and risk of foreclosure and loss. In some circumstance that amount of the loss may even exceed the amount of a potential judgment.

The crucial element of asset protection planning is creating the proper strategy to hold interests in an FLP, LLC, corporation or any other entity in the structure.

Ownership by Children

A transfer of ownership of the limited partnership interests to a child or children may provide a good solution. A lawsuit against H or W would not impact the partnership interests because ownership is no longer in the name of H or W. Although H and W may retain control, directly or indirectly over the assets as general partner, there are no limited partnership interests available for the plaintiff. H and W have effectively protected assets by gifting the limited partnership interests to their children.

The disadvantage is that a direct gift in this form may create gift tax liability, depending upon the amount involved. Further, the children have legal rights as limited partners which must be respected. The gift to the children is real under this arrangement, so assets in the FLP must be those which H and W are willing to part with. Those in a position to make an irrevocable transfer to their children may accomplish good asset protection with this strategy.

Ownership by Family Savings Trust

A popular alternative for asset protection and for owning FLP interests is to transfer the ownership into a trust which is designed for this purpose - generally known as a Family Savings Trust. The Family Savings Trust is discussed in **Chapter 5**.

Ownership by Offshore Limited Liability Company

The Offshore LLC provides excellent protection for FLP interests as well as enhanced asset protection features. We will discuss the Offshore LLC in **Chapter 6**.

Conclusion

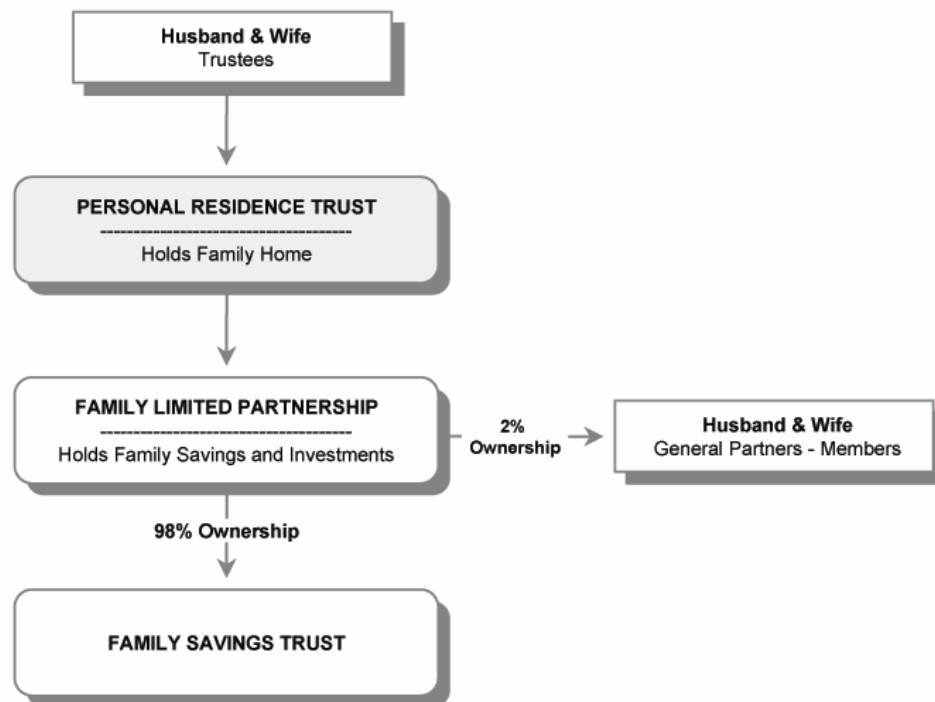
Based upon what is intended to be accomplished and the type of assets involved, creating an asset protection plan sometimes involves forming one or more Family Limited Partnerships, Limited Liability Companies or other entities. The key question in these cases is how to hold the interest in these entities. We discussed the fact that owning the interests in your name allows a creditor to obtain a charging order or to foreclose and seize those interests. Generally, we have found that a trust or Offshore LLC designed to own these entities provides excellent flexibility and convenience and achieves all or most of the goals of a solid asset protection plan.

The Personal Residence Trust

Your family home should not be placed in the FLP or an LLC. A personal residence is entitled to certain tax advantages that will not be available if the home is placed in the FLP/LLC. These advantages are primarily the mortgage interest deduction and the \$250,000 per spouse capital gain exclusion. Although there is no clear law on the subject it seems that it would be foolish to risk a denial of these benefits.

The most popular alternative is to place the residence in a Personal Residence Trust. This is a grantor-type of trust, specifically permitted under the Internal Revenue Code. You or you and your spouse can be the trustees of the trust. As such you have full power to buy, sell or refinance the property. The interest deduction is reported directly on your tax return and all of the other advantages of home ownership are preserved.

The FLP/LLC is designated as the beneficiary of the trust. In this manner your home receives all the protection provided by these entities without creating any tax difficulties.



The Family Savings Trust

The Family Savings Trust is a broad descriptive term for a trust intended to hold and protect assets against lawsuits and business risks. A Family Savings Trust is extremely flexible in form and almost any asset protection and estate planning goal can be accomplished by an attorney who is knowledgeable and experienced in this field. Using creative trust strategies, the planning opportunities for achieving tax savings and asset protection advantages are unlimited.

Public opinion, policy and the law in general is now favorable to asset protection planning with trusts, as long as the planning is not intended to defraud creditors or violate existing laws against Fraudulent Transfers.

Based on these new laws and advances in technique, trusts can be designed which combine the best features of domestic and even offshore arrangements within a single trust. All of your assets can be held within the trust--but governed by special terms appropriate for that asset.

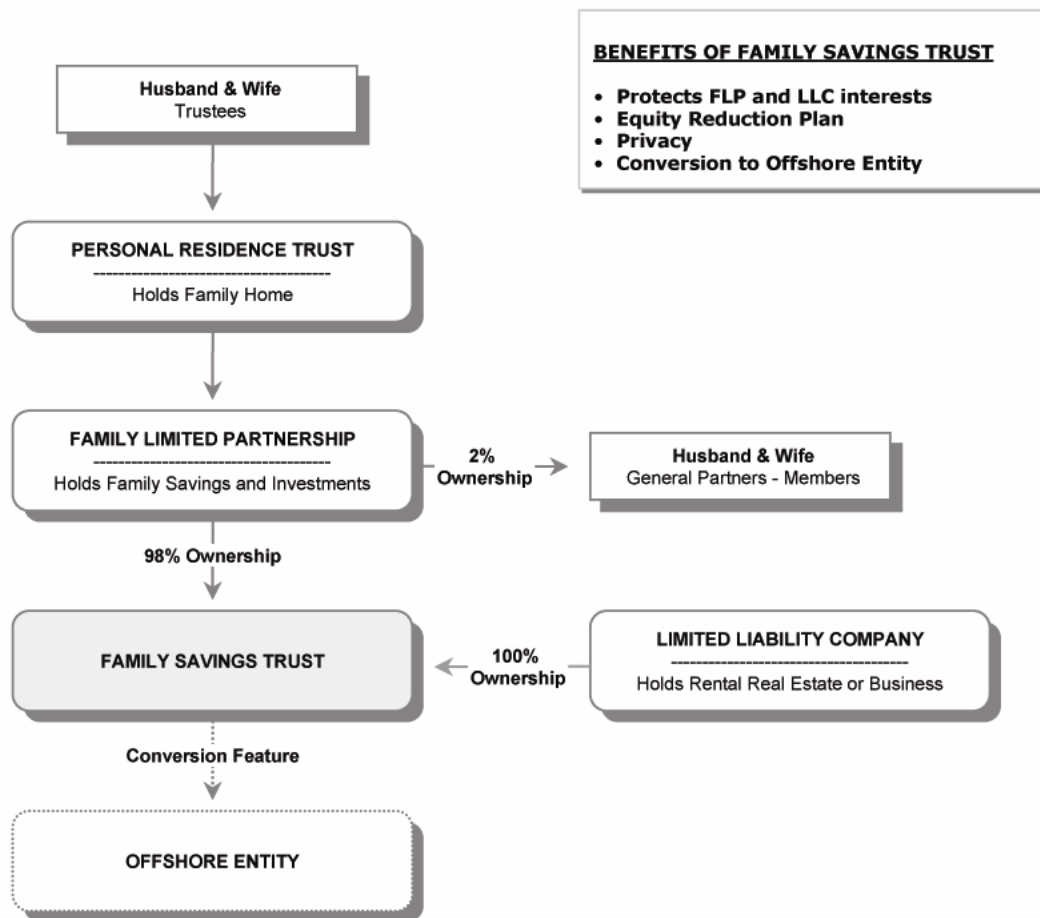
For example, your trust may be designed to hold your home, accounts receivable, and your savings and brokerage accounts. Or the trust can own the entities, such as an FLP or LLC or a Personal Residence Trust. This trust may contain specific language to:

- **Protect your residence while preserving the tax benefits associated with the home (mortgage interest, property taxes, avoidance of gain in sale;**
- **Protect your LLC (or FLP) interests from charging order or foreclosure**
- **Protect your accounts receivable or other business assets with an equity reduction strategy**
- **Protect your savings and brokerage accounts**
- **Create the degree of privacy that you wish to accomplish**
- **Provide the traditional estate planning features of a living trust as well as advanced estate tax savings measures if needed.**

Depending upon your goals and the circumstances of your case, a Family Savings Trust may be designed to permit you to retain the level of control and continued enjoyment of your property that you wish to retain. The trust may permit you to serve as a special beneficiary, with current rights to income and principle. Or, you may prefer to set aside and protect your savings until retirement. If you do not need to use the current income from your investments while you are practicing, this type of arrangement may provide excellent protection with maximum flexibility.

The Physician's Guide to Asset Protection Planning

An additional feature, which can be added to a Family Savings Trust, if desired, allows the trust to obtain certain "offshore" advantages, at some later point. For example, the trust can be structured to permit a migration of the trust to a more favorable jurisdiction - domestic or foreign - when and if necessary. In the right situation, this provision can be used to force any future plaintiff to proceed with a lawsuit against you in a string of unfriendly foreign jurisdictions to which the trust has continuously migrated. For example, under normal circumstances, the trust exists and is governed by whatever domestic law we choose. But, if circumstances warrant, and strategy dictates, we can convert all or a portion of the trust or its assets into an Offshore Trust or Offshore LLC- legally protected and effectively out of reach. A plaintiff attempting to litigate in a foreign country, would be faced with nearly impossible hurdles, subject only to local Fraudulent Transfer rules and the applicable Statutes of Limitations



The Offshore Limited Liability Company

Asset protection planning can sometimes be enhanced with the addition of an offshore component to the structure. One strategy that we consider in our planning is the Offshore Limited Liability Company. It is comparatively simple to create and maintain and has a number of distinct advantages over domestic and other offshore plans.

The Offshore LLC may be most appropriate for those in high-risk medical specialties and those for whom insurance coverage is inadequate or unavailable.

Advantages

- **Creditor can't reach assets**
- **Offshore LLC is disregarded for tax purposes. No returns or informational filings are required.**
- **Estate tax advantages are the same as the Family Limited Partnership.**

Creditor Can't Reach Assets

Assets in the Offshore LLC can't be reached by a creditor because of the "charging order" limitations and the legal and practical inability to collect against the Offshore LLC in a foreign jurisdiction.

A "charging order" against an LLC membership interest, giving the creditor a right to receive any actual distributions to the debtor member, will not be an effective remedy, since no distributions will be made under those circumstances. Neither the Offshore LLC nor its manager can be compelled to liquidate assets or distribute funds - even if the collection litigation is attempted in the foreign jurisdiction where the Offshore LLC is formed.

No Tax Burdens

In an effort to combat tax evasion through the use of offshore entities, substantial IRS filing and reporting requirements are imposed on foreign trusts, offshore corporations and foreign partnerships.

But the Treasury Regulations treat the Offshore LLC, just like a domestic LLC. If intended to qualify, it can elect to be disregarded for federal tax purposes. That means no tax returns or informational filings are required other than the initial election to be treated as a disregarded entity. All income is reported directly on the owner's personal return and the existence of the Offshore LLC is ignored for tax reporting.

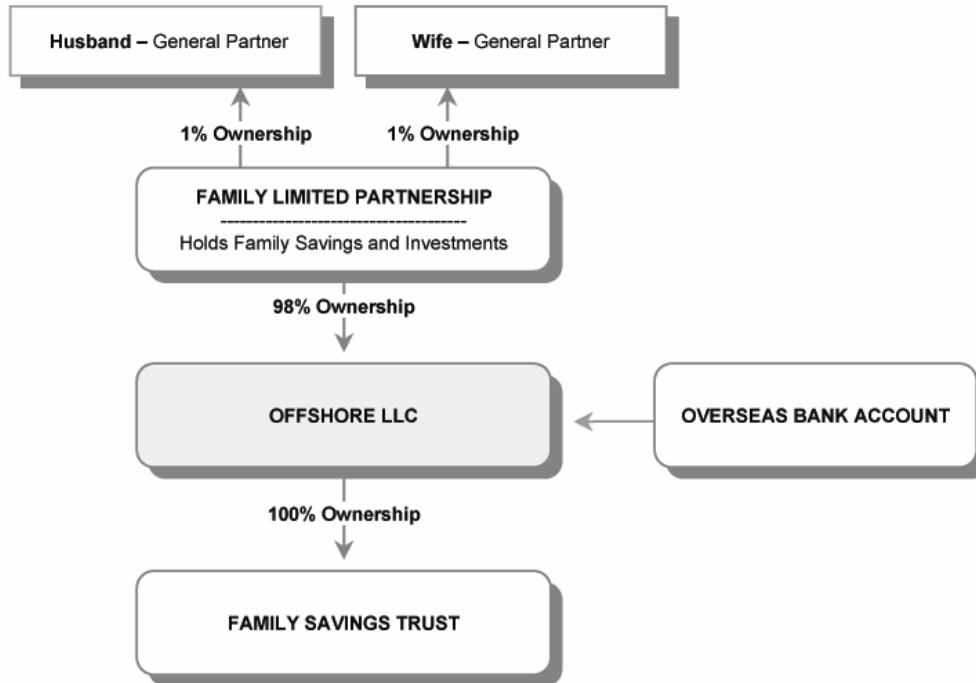
Estate Tax Savings

As we discussed with the FLP, membership interests in an Offshore LLC can be transferred to family members at a discount for significant estate tax savings.

The Physician’s Guide to Asset Protection Planning

Example of the Offshore LLC

Form a Family Limited Partnership to hold your savings and brokerage accounts. The limited partnership interests in the FLP will be held by the Offshore LLC. We will protect the ownership of the Offshore LLC by holding membership interests in the Family Savings Trust.



Under this arrangement, savings and brokerage accounts are well insulated in the FLP. But we opened up new tactics and levels of protection with the Offshore LLC.

To combat a perceived threat, or to take advantage of investment opportunities, at any point in the future, assets of the FLP can be moved into an overseas account in the name of the Offshore LLC. If there is a subsequent judgment against you, even a charging order is unlikely since you do not own interests in the FLP or Offshore LLC. Any collection order would be without enforcement capabilities in the U.S.

If litigated in the jurisdiction where the Offshore LLC is formed, it is likely that the creditor would have to prove that any transfers were a violation of the applicable Fraudulent Transfer laws and such a claim would have to be initiated within the Statute of Limitations period (generally one or two years). The obstacles presented by this arrangement, and other features which can be added, provide an excellent legal shield against even the most aggressive and determined plaintiffs

The Offshore LLC is a fairly simple and effective asset protection tool. It reinforces the available domestic protection, supplementing available malpractice insurance, for those with significant lawsuit risks. Tax filings and returns can be eliminated. Administration and money management issues only arise at the time, if ever, that the Offshore LLC is funded with bank or brokerage accounts.

Equity Reduction Plan

An Equity Reduction Plan (“ERP”), is a highly effective and sophisticated form of asset protection. Depending on the circumstances and the type of assets involved, an ERP can be used by itself or in combination with other techniques. An ERP is designed to protect equity in real estate or business assets from a potential future claim.

Real estate assets are always vulnerable to a lawsuit. During the last 10 years there has been a dramatic increase in the value of most properties. A significant portion of your net worth may have shifted from stocks to real estate equity.

Physicians and other professionals have additional value locked inside their practice in the form of accounts receivable and equipment. A lawsuit against the practice from a patient or employee exposes these assets to risk of loss.

Business owners may have inventory, equipment, patents, and trademarks in addition to accounts receivable. If these assets have value it is logical and prudent to protect them from the risks of the business.

In many situations, where movement of an asset is impossible or impractical, an ERP can move the equity or the value of an asset into a protected position. Ownership of the underlying property remains the same and need not be transferred. This is a clear advantage in many situations:

- Those who own multiple properties can avoid the inconvenience and cost associated with forming several Limited Liability Companies.
- An ERP protects the equity in a property from a claim arising out of the property itself (an “inside” liability). This cannot be accomplished with a LLC or any other entity.
- An ERP avoids a transfer of real estate ownership and potential problems with increased property taxes, transfer taxes and due on sale clauses from a lender.
- Accounts receivable usually cannot be transferred out of a professional practice because of accounting problems and insurance company restrictions. An ERP is the only technique available to insure the protection of the cash flow cycle of billing and collection.
- Similarly, the inventory, equipment and intellectual property in a business are essential for operations and future success. An ERP is designed to avoid disruption or loss of the business by protecting these assets.
- Valuable but unproductive equity in real estate, accounts receivable and business property can be leveraged for business or investment purposes. These dormant assets can be put to work in an ERP, enhancing asset protection and generating additional income.

The Physician's Guide to Asset Protection Planning

We can make these advantages clear with several examples of how an ERP solved particular asset protection problems.

Client A owned 6 rental houses that he had purchased and renovated over the years. Most of his surplus cash went into buying and fixing up the properties. Sometimes he sold a property and reinvested the proceeds.

Our view is that rental real estate is always a "Dangerous Asset" creating potential lawsuit liability from tenants, visitors and buyers and sellers. There are three possible asset protection plans:

Plan #1

All the properties in one LLC. We could form one LLC and put all the properties in that single company.

Advantage - Client is protected from liability associated with the properties. He cannot be sued if there is a claim arising from any property. This is also relatively inexpensive to establish and maintain.

Disadvantage - The combined equity of the properties is available to satisfy a claim arising from any property. If someone is injured at one property and successfully sues the LLC owner, the equity value of each property is exposed to this claim

Plan #2

Separate Limited Liability Companies. We could form six new LLCs and transfer each property to its own LLC.

Advantage - A liability produced by one of the properties would be insulated and contained. Neither the other properties nor Client would be at risk.

Disadvantage - The equity in the particular property is exposed to the liability created by that property. If a tenant is injured in the house owned by LLC #1, although the other properties are not exposed, the equity in that property is available to satisfy the claim. Potential loss has been substantially reduced but still remains.

Plan #3

An ERP presents a partial or complete solution.

Advantage - We can form one LLC to limit Client's exposure to liability from all of the properties. By transferring property equity into an ERP, no portion of the accumulated equity is at risk. An accident at one property presents no risk to the equity of that property or to the equity in other properties. Whatever value has accumulated in the properties is shielded from any liability-regardless of the source. If the Client is sued for any reason, 100% of the value of the properties has been protected.

Disadvantage - We achieve full protection which could not be accomplished in any other way so there is no particular disadvantage to this plan. As with all asset protection plans, the cost of insuring against a risk must be weighed against the amount of the potential loss. It doesn't make sense to pay \$100 to insure an asset with \$100 in value. Depending upon the degree of risk involved it may make sense to pay \$100 to insure an asset worth \$5,000. Legal fees and maintenance costs for an ERP must be balanced against the amount and likelihood of a potential liability.

Equity Reduction Plan

Client B owns a commercial property with substantial equity.

The analysis should be clear. If we put the building in an LLC we protect Client against liabilities arising from the property. However, the full amount of the equity is exposed in the event of such a claim. Again, we would form an LLC to hold the property and use an ERP to protect the value.

Client C is a physician with valuable accounts receivable in his practice.

Sometimes, transferring an asset, such as accounts receivable will create tax, accounting or administrative problems. Instead, an ERP legally transfers the equity in the asset, not the asset itself into a protected position. Using this approach we avoid difficult issues but still protect the accounts receivable. If Client C is sued someday in the future, instead of losing the collections on the accounts receivable, funds are protected in the ERP and cannot be seized by a successful plaintiff.

An ERP is remarkably efficient and convenient to establish considering the advantages which can be obtained. We do not need a complicated, high maintenance plan. An ERP will usually fit within a popular asset protection structure such as a Family Savings Trust or Offshore Limited Liability Company.

A contract is developed, supported by a lien or mortgage on the underlying assets and this "equity" is gifted or "sold" to the trust or to an entity owned by the trust for that particular purpose. The equity can then be borrowed against for investment or business purposes. Banks and finance companies specializing in these equity backed loans often lend 90% to 100% of the value of the collateral with a reliable appraisal and proper legal documentation.

In the event of a lawsuit or claim, the lien of the ERP is superior to the claim of the judgment creditor. First, proceeds go to the ERP. Only excess proceeds, over the ERP amount, are available to satisfy the judgment claim. Care must be taken when the ERP is created and reviewed regularly, to insure the correct value of the underlying assets.

When used in this manner, as an integral component of a sound plan, an ERP minimizes the liability risk to business assets and protects accumulated real estate equity in the most convenient and adaptable format developed.

Summary of Asset Protection Strategies

We have now presented six strategies to complete the asset protection component of your financial plan: 1) The Family Limited Partnership 2) The Limited Liability Company 3) The Personal Residence Trust 4) The Family Savings Trust 5) The Offshore Limited Liability Company and 6) The Equity Reduction Plan

To assist you in determining the proper plan, we will provide some very basic illustrations and examples of how we might choose the appropriate plan for you. Because the circumstances of every individual case are different we cannot create any fixed rules regarding the appropriate strategy for you. However, these general examples can provide you with a starting place for considering the various options.

The Family Limited Partnership

The FLP is an excellent tool for protecting Safe Assets such as savings and brokerage accounts. In addition, if you have an estate that may be subject to future estate taxes, the FLP can be used to create significant tax savings.

The Limited Liability Company

If you own rental real estate or other Dangerous Assets we will always place that property in an LLC. This protects you from personal liability arising from the property.

The Personal Residence Trust

If you have substantial equity in your home, the Personal Residence Trust is an effective strategy. The PRT is always used in conjunction with a FLP or LLC. The residence is placed in the PRT and other family assets are protected in the FLP/LLC.

The Family Savings Trust

When our goal is asset protection, we use the Family Savings Trust by itself or in combination with the Family Limited Partnership or LLC. We are able to incorporate a broad variety of features within the trust at a level that is likely to meet all or most of your asset protection, estate planning and privacy objectives.

The Offshore Limited Liability Company

For those with a high liability risk, the Offshore LLC is a powerful weapon for self-defense. It is easy to establish and maintain. In addition it increases your flexibility, negotiating leverage and your ability to defeat a potential adversary.

Equity Reduction Plan

Substantial equity in real estate, accounts receivable and business equipment can be well protected from liability with an Equity Reduction Plan. This is usually structured as an important feature of the Family Savings Trust or an Offshore Limited Liability Company.

The following examples will provide you with a more detailed explanation of the strategies which we use in a variety of circumstances.

Choosing the Right Plan

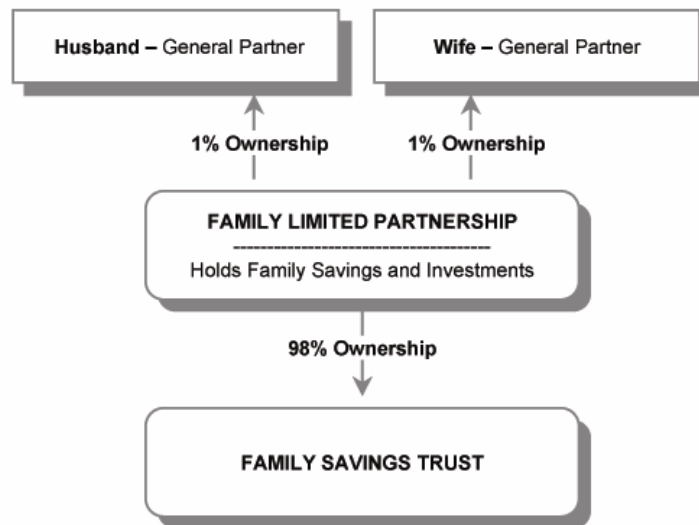
Example #1

Facts

The client is a physician anticipating retirement in 10 years. He has two grown children. He has non-retirement account savings of \$500,000 in mutual funds and brokerage accounts. He is not in a high-risk specialty and hopes that his insurance coverage is adequate. He wants to make sure that his life savings are protected against any type of future lawsuit or claim.

Analysis

We would recommend that the client establish a Family Limited Partnership. All of his savings and investments would be transferred into the name of the FLP. Ownership of the FLP would be held by the Family Savings Trust, designed to protect the limited partnership interests in the FLP from charging order or foreclosure. The Family Savings Trust can also integrate or establish necessary estate planning to avoid probate and minimize estate taxes if necessary.



The Physician's Guide to Asset Protection Planning

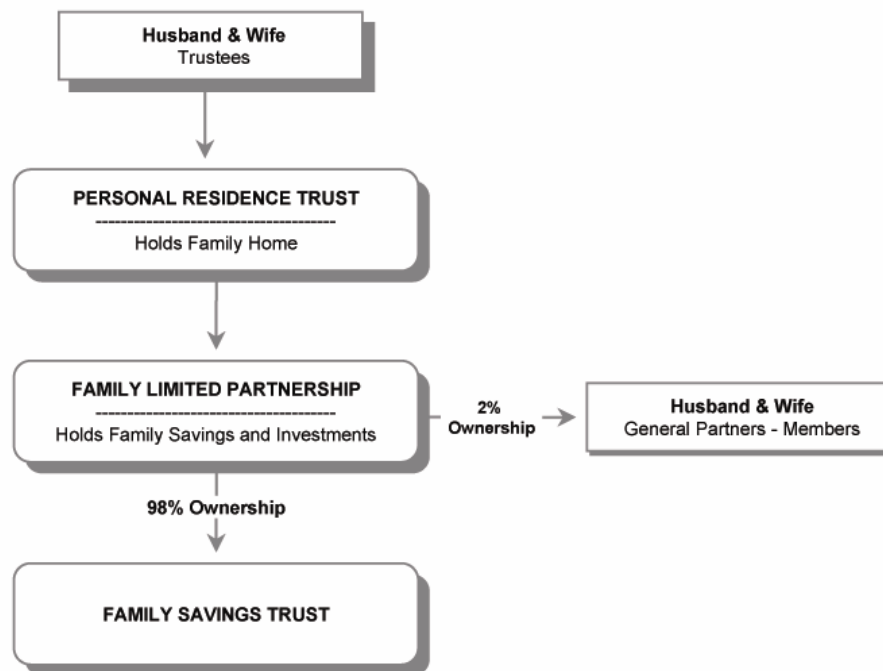
Example #2

Facts

The clients have a home with equity that they wish to protect. They are practicing physicians with savings of \$300,000 in mutual funds, annuities and stocks.

Analysis

The Family Limited Partnership can be used to protect liquid assets. The limited partnership interests can be held by the Family Savings Trust. The home is placed in the Personal Residence Trust. The clients are the trustees of this trust and the Family Limited Partnership is the beneficiary.



Choosing the Right Plan

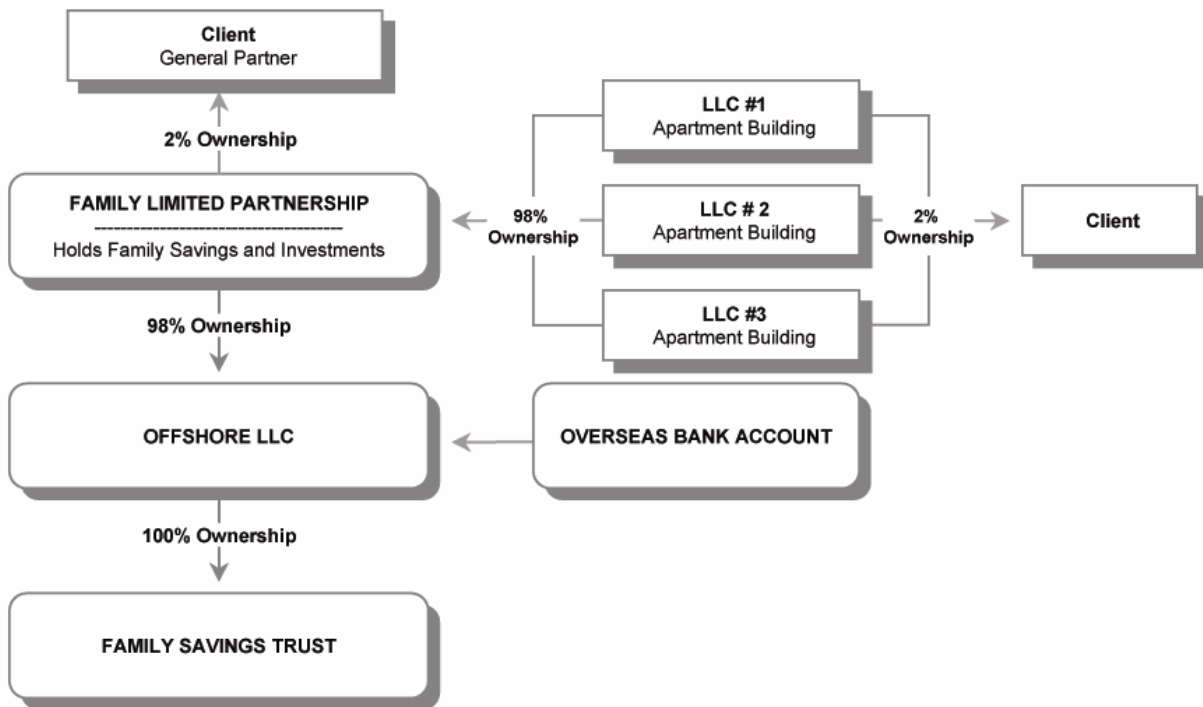
Example #3

Facts

The client is a physician and an active real-estate investor. He owns three apartment buildings and has \$1 million in liquid savings.

Analysis

The client faces the highest degree of potential liability. In addition to the liability he faces with his practice, the apartment buildings are Dangerous Assets, likely to produce a lawsuit at some point in the future. The properties should each be held in separate LLCs. A lawsuit involving one of the properties would not affect the others and the client would not be responsible for any debts of a LLC. The client's liquid assets could be placed in a Family Limited Partnership. That will allow him to take advantage of estate planning opportunities to minimize potential taxes. We would also advise the client to establish an Offshore LLC to hold the interests in the FLP. An overseas Trust Account would be created and funds could be transferred at any time the client wished. A Family Savings Trust owns the Offshore LLC.



Questions and Answers

Who needs asset protection?

An individual who is not able to adequately insure against his liability risks needs some form of asset protection planning. The threshold question for each individual is "Do I have any liability risk?"

Many, or most people do not have a serious liability risk. Despite all the talk and the hype, most people are not going to be sued. Those who are employed at a job do not face the same risk that business owners face. Similarly, an individual, not engaged in business, whose primary asset is his home, will generally be protected from liability by homeowners insurance.

Some form of business activity is usually what creates liability risk. Practicing medicine, and ownership of rental real estate and or real estate development are both at the highest end of the scale in terms of producing liability and risk to personal assets. Owning almost any type of business creates significant potential liability to customers, lenders, vendors, landlords and employees.

What is a fraudulent transfer?

The favorable results which are available from asset protection planning will not be accomplished if it is determined that the transfer of the asset to the asset protection plan was a Fraudulent Transfer. The law in every state prohibits the transfer of property with the intent to defraud a creditor. This law also provides that a transfer which leaves you unable to meet your legitimate obligations is a Fraudulent Transfer. The effect of this law is that if you set up the asset protection plan at a time when there is a claim against you and you do not reserve a sufficient amount to be able to meet that claim, the transfer can be set aside by a court.

Asset protection is not a tool which can be used to avoid paying rightful claims and obligations. However, when used properly and established in advance these techniques provide a powerful and logical legal strategy for preserving family assets.

Will I be protected from lawsuits if I give all my property to my wife?

A gift of property which is not a fraudulent conveyance will be effective in removing that property from the husband's potential creditors. However, if after the gift the husband continues to enjoy the use of the property, a court may find that the gift was not really a gift. For example, if the husband transfers title to the family house to his wife and continues to live in the house, a court could find that the transfer created an implied trust for the benefit of both husband and wife. An implied trust would be found if the court determined that there was an agreement or understanding between the husband and wife that the property would be held by the wife for their joint benefit. Such a finding would negate the gift and would allow the creditors of the husband to reach his interest in the house. Gifts which are made to a spouse, in trust may eliminate this problem. An express trust, one whose terms are fully written, is more likely to withstand attack than an outright gift.

The Physician's Guide to Asset Protection Planning

Is an Offshore LLC different than an Offshore Trust?

Both strategies rely on a similar premise; forcing a U.S. creditor to litigate and attempt to collect a judgment in an unfriendly foreign jurisdiction. Because of the costs to the plaintiff and the unrealistic chance of success, most lawsuits will be discouraged before they begin. The plaintiff and his lawyer have no economic incentive to pursue a defendant with unreachable and unavailable assets.

The Offshore Trust, also known as an Asset Protection Trust, involves a more complicated structure, with more internal variations. A trust company, acting as trustee, has serious, legitimate responsibilities to the trust beneficiaries. Matters of international banking, estate planning and taxation create a variety of complex personal and legal issues for client, attorney and trustee. It is not unusual for legal fees and costs for a sophisticated Asset Protection Trust to exceed \$20,000.

Progressive legislation from the offshore financial centers makes the filing and administration of Offshore LLC's comparatively easy and therefore less expensive than the trust arrangement. Properly formed Offshore LLC's can also avoid filings and tax reporting which are sometimes an inconvenience for the Asset Protection Trust.

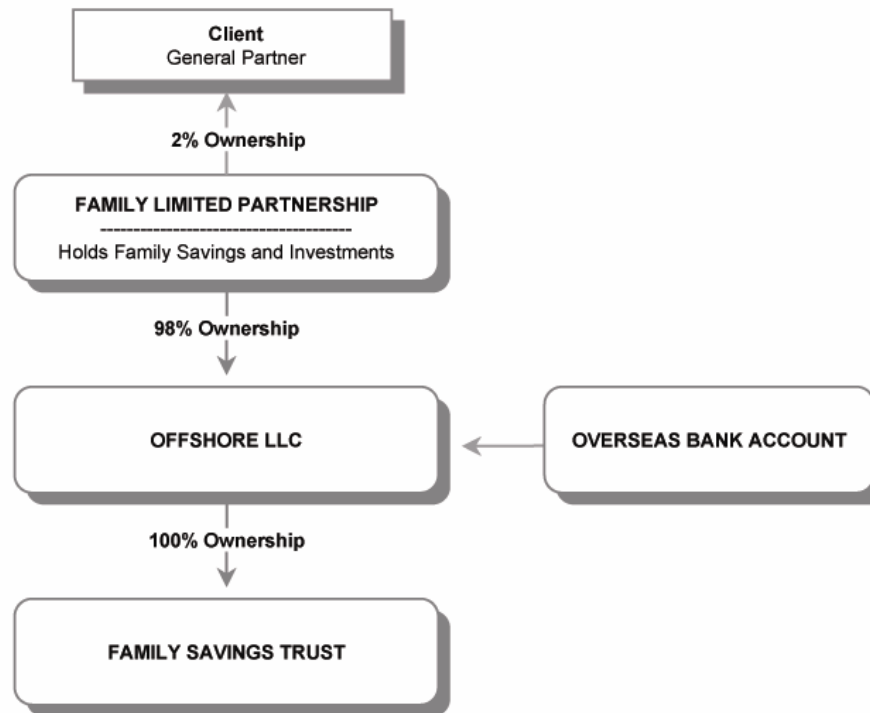
Many of our clients, seeking the enhanced protection of an offshore component of their plan, choose the Offshore LLC for the lower cost and relative ease of operating the plan. Others, comfortable with more complex business and financial matters, find the Asset Protection Trust useful for their situation. As always, competent legal advice is necessary to evaluate the merits of each strategy based upon your particular needs and concerns.

Can you provide a summary of how all of the pieces of the asset protection plan fit together?

Here is an example of how the asset protection plan operates from a practical standpoint. James and Mary Prudence are physicians with \$2 million in liquid assets. They hope to retire in about 10 years. They have no lawsuits and no potential claims against them. The continued availability of malpractice insurance is uncertain. They want to make sure that their savings are protected in the event of any future difficulties.

Questions and Answers

Their plan consists of Family Limited Partnership to hold their “safe” liquid assets. An offshore LLC acts as a “Safety Valve” on the plan. We protect ownership of the Offshore LLC in the Family Savings Trust. The plan is both reasonable to administer and sufficiently tight to accomplish their goals.



Now let's see what happens if there is ever someone who is thinking about suing Mary for malpractice. As we know, the plaintiff's lawyer will want to know whether it is worth his time and money to pursue Mary in a lawsuit. When he performs an asset search, he is unable to locate any property in the name of either James and Mary, since they have previously transferred their property into the plan. It is very unlikely that he would proceed at this point.

But let's say that the lawsuit is filed and Mary loses with a large verdict. Now what happens?

After the lawsuit the collection process begins with a Debtor's Examination, with detailed questions concerning the sources of income and the location of assets. Clearly, if James and Mary had not transferred their assets into the plan, the judgment creditor would simply have levied on their house, office building and accounts and would have taken everything. There would be no room to negotiate and no leverage to attempt to work out a deal or a payment schedule. Under normal circumstances a creditor with a judgment has complete control over your assets.

The Physician's Guide to Asset Protection Planning

Now the situation is quite different. First of all, Mary will truthfully answer all of the questions in the judgment debtor exam. She will describe the plan in detail. The purpose of the arrangement is not to hide or conceal assets from a creditor, but to provide legal protection, allowing you to answer all questions truthfully and completely.

Now that the plaintiff knows how the assets are held, what does he do? Will he be able to collect on his judgment? The plaintiff would like to seize the savings account in the FLP but he cannot do that. As we have discussed, a creditor is not permitted to reach the assets of an FLP.

What is the next move? Could the plaintiff try to compel Mary to liquidate the FLP? Neither of the other partners, James or the Offshore LLC would consent to that.

What about a charging order or foreclosure of Mary's interest in the FLP? All of the limited partnership interests are held by Offshore LLC, so there is no property of Mary's subject to this remedy.

What about the Offshore LLC? Is there anything there to take? We can see that the Offshore LLC is owned by the Family Savings Trust which protects those interests. There is no way in for the plaintiff. If Mary needed or wished to create a further tactical advantage she could have transferred the money from the FLP into the Offshore LLC account.

At this point the plaintiff will certainly be willing to settle for pennies on the dollar. Mary can now choose to settle on her terms. As a practical matter, James and Mary clearly produced a very successful result. They set up their plan before any problems existed and as a result their valuable assets and retirement nest-egg were safely shielded and protected from the hazards of their medical practice.

For more information on asset protection issues, visit our website, **The Asset Protection Law Center** at www.rjmintz.com. If you would like a specific proposal, go to Free Online Proposal and Fee Quote on our website or call us at 1(800) 223-4291.